SECRET

22 November 1963

SC No. 00619/63A
Copy No. 3

# SPECIAL REPORT

## THE ITALIAN ECONOMIC OUTLOOK



CENTRAL INTELLIGENCE AGENCY
OFFICE OF CURRENT INTELLIGENCE



~~NO FOREIGN DISSEM~~

~~SECRET~~

~~GROUP 1 Excluded from automatic downgrading and declassification~~

THIS MATERIAL CONTAINS INFORMATION AFFECTING THE NATIONAL DEFENSE OF THE UNITED STATES WITHIN THE MEANING OF THE ESPIONAGE LAWS, TITLE 18, USC, SECTIONS 793 AND 794, THE TRANSMISSION OR REVELATION OF WHICH IN ANY MANNER TO AN UNAUTHORIZED PERSON IS PROHIBITED BY LAW.

DISSEMINATION CONTROLS

This document MUST NOT BE RELEASED TO FOREIGN GOVERNMENTS. If marked with specific dissemination controls in accordance with the provisions of DCID 1/7, the document must be handled within the framework of the limitation so imposed.

APPROVED FOR RELEASE
DATE: NOV 2000

22 November 1963

# THE ITALIAN ECONOMIC OUTLOOK

Italy's economic boom is cracking a little at several points. Industrial output is at a record high, but nervous Italians send their funds out of the country as inflationary pressures persist and balance of payments deficits run on. The economic outlook is also clouded by widespread apprehensions about the concessions to Socialist viewpoints that will have to be made if a center-left government is to be formed and kept going. To allay these anxieties, the Italian Socialist Party has indicated that it intends, for the present at least, to support conservative financial policies designed to prolong the boom within the framework of capitalist institutions.

## The Postwar Economy

Italy drew economic strength from military defeat. The public debt was effectively wiped out by a galloping inflation that was arrested after 1947. No large public expenditures were required for defense or for support of colonies. Restrictions on the free movement of labor were repealed, price controls were lifted, and other interventionist economic policies of the Fascist regime were discarded. While the state sector of the economy was still very important, the free play of market forces after World War II generated a new spirit of enterprise and promoted technological advances in industry.

The fortuitous discovery of new energy sources also helped fuel the "takeoff." Just after the war, natural gas was discovered in great quantities in the Po Valley and became the principal fuel of the Milan-Genoa-Turin industrial triangle. The abundance of fuels was directly responsible for the rise of a petrochemical industry that has made Italy a leading European producer of plastics and other synthetics.

The success story of petrochemicals is part of the larger experience that Italians describe as their miracolo economico. The miracle is a record of dynamic growth in such fields as sewing machines, typewriters, calculating machines, steel, and autos. Between 1949 and 1953, production of passenger autos doubled from 86,000 to 174,000 annually. By 1957, output had redoubled to 352,000. Last year's figure of 878,000 was two and a half times as high again.

The miracolo operated up to 1961 in a setting of extraordinary price stability. The large numbers of unemployed and underemployed in Italy permitted production to expand without an undue rise in wages. Workers' incomes did go up, but labor productivity increased even faster, and profit margins were high. The reinvestment of a high proportion of business earnings sustained a steady growth of GNP, which rose more than 5 percent annually (in constant prices) from 1950 to 1958. The rate of increase in GNP was about 8 percent in 1959, 7 percent in 1960, 8 percent again in 1961. Last year, the rise was a little over 6 percent, still among the highest in the world. The percentage increase this year will be lower, but substantial nonetheless.

## Inflationary Pressures

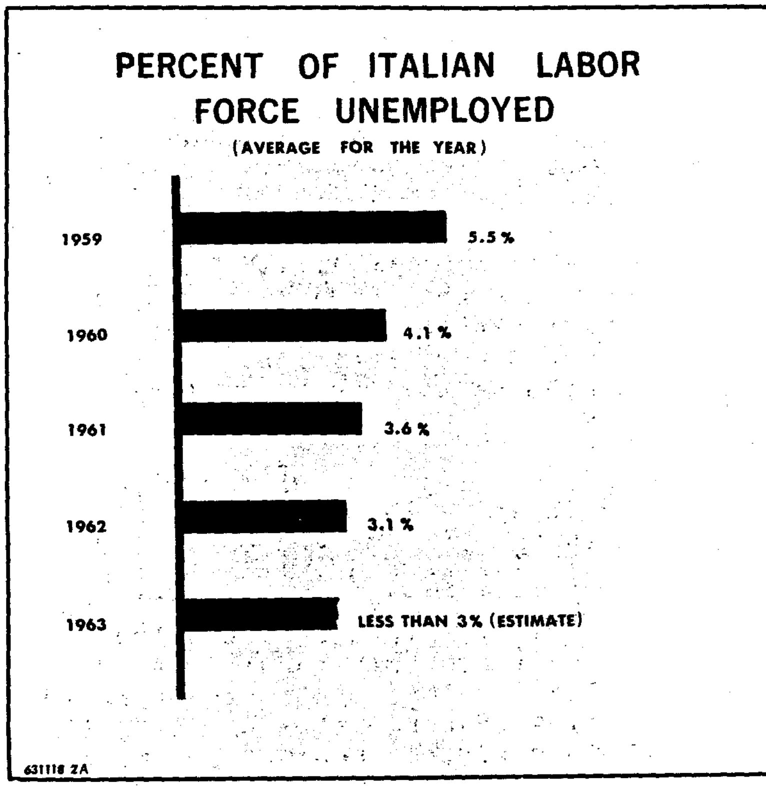
Industrial expansion now has proceeded far enough to take most of the slack out of the labor market. On top of the economic forces, new demographic patterns also make for a tighter labor market. The industrial labor reserve represented by the rural population has dropped sharply; nearly half the workers were on the farm just before World War II, whereas the proportion now is little more than a quarter. In addition, population growth no longer outstrips the demand for labor. Italy's rate of population increase has been only a fraction of one percent annually in the past decade. With 50-odd million people, Italy is still one of the more crowded countries in Europe, but the population problem is well on the way to solution.

The number of workers completely without jobs has been steadily diminishing and in some areas has been practically eliminated. In 1959, about five and one half percent of the labor force was unemployed, according to a statistical series that is approximately comparable with US unemployment figures. The rate of unemployment was down to an average of three and one half percent during 1961 and will be less than three percent this year--about half current rates of unemployment in the US. The Italian statistics do not reflect a substantial volume of underemployment and are not indicative of the higher unemployment figures in the south. They do, on the other

hand, indicate the shortage of labor in the industrial north that has strengthened the hand of labor unions in collective bargaining negotiations. Businessmen have recently had to make far-reaching wage and other concessions to the workers, entailing increases in labor costs of 20 to 30 percent.

Labor militancy feeds on the rising cost of living, and the familiar wage-price spiral has been one of the important factors responsible for an inflation that the European Common Market Commission describes as "serious." The cost-of-living index went up more than seven and one half percent between mid-1961 and mid-1962. Another eight-percent rise was recorded for the twelve months following. The country's currency supply expanded some 18 percent in 1962, and it will probably go up by much the same percentage again this year. Persistent government deficits account for a significant amount of the increased money supply.

The inflation has adversely affected Italy's balance of payments in two ways. First, the demand for foreign goods has climbed with the increase in purchasing power and with government measures to lower the barriers on food imports in order to keep the cost of living down. Second, rises in the prices of Italian manufacturers have reduced Italy's competitive advantage in foreign markets, and exports have lagged behind the increase in imports.




Italy has traditionally had an excess of imports over exports, but the gap now is so wide that it can no longer be covered by earnings from "invisibles" like tourism and emigrant remittances. In the years from 1958 to 1961, exports and "invisibles" helped bring a surplus in the balance of payments averaging $650 million annually. The fall in the surplus to only $50 million in 1962 came as sobering indication of the fragility of the boom. Soberness has deepened into concern with the publication of financial statistics pointing to a balance of payments deficit this year that will come close to a billion dollars.

The Climate of Uncertainty

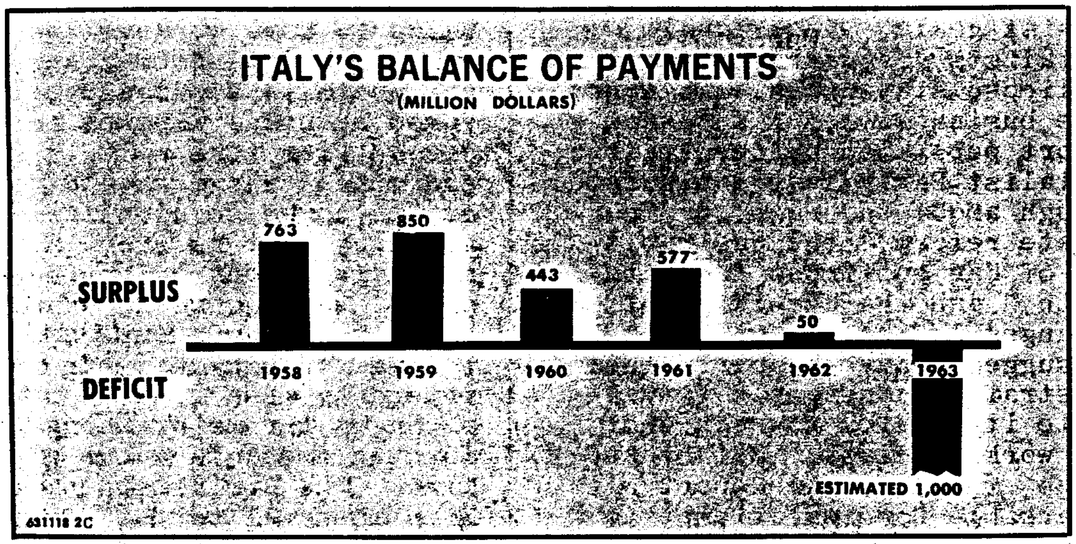
Several economic signs attest to widespread uneasiness. New investment decisions are being postponed. In part, this is due to the increasing difficulty of selling new securities to finance business expansion. Savers show a clear preference for bank deposits over stocks and bonds; some Italians are sending their money out of the country entirely.

The extent of the capital flight is indeterminate, although it has been estimated as high as a billion dollars so far this year. Not all the capital flight reflects fears about economic conditions in Italy. Some of it was prompted by a 15-percent withholding tax on dividend income. The mandatory registration of dividend receivers under the new tax law--disclosing large blocks of securities acquired by individuals with low declared incomes--put a new burden on tax evaders. They have reacted by selling their securities and sending the lire in suitcases to Switzerland. The money may be kept in Swiss banks or invested in foreign securities. A good part comes back to Italy again in the guise of investments by Swiss business firms, which are in fact acting for their unnamed Italian principals.

A strong government could do much to restore business confidence. The present caretaker government made a gesture at a stabilization program with modest proposals for increases of certain taxes, for measures to stimulate exports, and for tax inducements to modernize factories and encourage low-cost housing construction. Banks are more restrictive in screening loans to their customers. A parliamentary group has proposed a new law to curb the sharp increase in rents--the fastest rising component of the cost-of-living index.

Even a stronger Italian government would find it difficult to hold the line against inflation and payments deficits. One reason is the general opinion in Italy that credit restraints must be approached cautiously--that it is desirable to curb, say, real estate speculation but that investment tending to increase production and bring down costs should be encouraged. Second, there is little stomach for the contest with labor that would follow an attempt to impose an "incomes policy" limiting wage increases. Unions argue, with justice, that labor is just now catching up with past increases in productivity. They also point out that wage scales in Italy are still far lower than going rates in other Common Market countries.

A third reason is the political necessity of honoring past commitments to correct some of the glaring inequities of the Italian economic structure. The disparities between north and south, for example, necessitate continued large




expenditures. Some 37 percent of the population lives in the south, in a predominantly agricultural setting where per capita earnings are half what they are in the north, where birth rates are 50 to 100 percent higher, and where unemployment and underemployment are chronic.

In 1950, the government created the Fund for the South, with investment resources that were directed initially to improvements in agriculture and such "social overhead" as roads, water supply, and electric power. The government is also trying to attract industry to the south by such measures as tax concessions and subsidies. Last year's investments there, totaling over 670 million dollars, were about a third of the amount invested in northern and central Italy. This proportion, which represents a considerable increase over previous years, will go still higher if official projections are realized. The concerns about inflation are not likely to weaken the determination to bring the south into the economic mainstream of the country.

## Reassurances From the Left

Last year, the electric power industry in Italy was nationalized. The specter of further socialization now haunts the business community as a possible consequence of a center-left government. If the fear proves unfounded, the stimulus to private investment and general economic improvement should be considerable. There seems to be an even chance that events will take this happier course, at least for the near future.

It is not that the left in Italy is jettisoning its

Marxist goals. Individual Socialists frequently issue bellicose statements that worry some businessmen. The Economic Report published by the Italian Socialist Party last month said enough about the need for "corporate reform," the desirability of "an antitrust law with teeth," and the necessity of "changes in the tax structure" to suggest that the party feels constrained constantly to validate its claims to represent the working class. But by and large, the Economic Report was remarkable for its attempt to allay conservative anxieties--in the words of the report at one point, "to dissipate preconceived fears in the business community that a center-left government would be, by nature, prodigal and spendthrift."

The report eschewed Marxist cliché and dialectic. It argued strongly against putting the blame for rising prices on wage increases, but it did not indulge in fundamentalist invective against profiteering or in other doctrinaire allusions to class conflict. The discussion of the stock market betrayed none of the typical Marxist animus against that oft-maligned institution of high finance. The decline of stock prices was accepted as a valid indicator of the economy's malaise, and the Socialists went so far as to endorse purchases of securities by the government to support the market, if other measures proved inadequate.

The report's concluding recommendations offered something to both workers and capitalists. The former, urged the Socialists, should be favored by price freezes on key commodities like milk, sugar, and rice. There should be credit curbs on speculative activity, but residential construction ought to be encouraged. Looking to the capitalists, the report implicitly professed its rapport with their interests when it came out strongly for maintaining the foreign exchange value of the lira. The Socialists pointed with approval to the stand-by arrangements for currency support that the United States has made with central banks of other countries. While refusing to condemn deficit spending, the report suggested that, for the present, it would be wiser to hold the line: proposals for additional public spending should not be made without offsetting proposals to cut expenditures in another area.

## Outlook

The assurances of the Socialists have no appeal to CONFINDUSTRIA (Italy's equivalent of the National Association of Manufacturers), which is reliably reported to have determined that neither effort nor money must be spared in the continuing struggle against the left. CONFINDUSTRIA's suspicions are likely to be reinforced periodically, as the Socialists, under Communist taunts, feel compelled to reassert their militancy against capitalist interests. To assume a viable center-left coalition under these circumstances is admittedly to assume away one of the central dangers--namely, that political instability or uncertainty will continue to cramp the Italian economy. However, if it turns out that the new government is in fact an enduring one, the forces for economic growth in Italy should carry the country over its present difficulties.

There are some unique structural defects of Italian capitalism, but the short-range problem is much like that of all capitalist economies during boom periods--largely one of coping with success. This means occasional business relapse, perhaps financial crisis. But in Italy, these will occur against a background of dynamism and upward trend lines. The spirit of business enterprise is widespread and venturesome. When governments are reasonably strong, this spirit is supplemented by practical political energy, as reflected in the ambitious but realistic plans for the south. Major plants being constructed or projected for the south will add significantly to the country's industrial capacity in chemicals, electric power, steel, and oil refining.

Both at home and abroad, the long-run outlook for Italian sales continues promising. The domestic market for Italian consumer durables, which has expanded steadily with rising incomes, is nowhere near saturation. The profitability of exports may have diminished, but the rising costs of production in Italy have their parallels in recent cost patterns of other European producers, so that the competitive position of Italian businessmen in foreign markets is still strong.

A final point, but one of central importance, is that Italy's economic boom is part of a wider prosperity. A critical factor in the Italian prospect is the performance of the Common Market. Italian duties are among the highest in the Community, and the Italian tariff wall was lowered despite protectionist fears about competition from more efficient producers of the EEC. Yet the Italians were able to make dramatic price cuts in autos, home appliances, and other durables, and they participate increasingly in the commerce of the expanding regional market. About a third of Italy's foreign trade is now with other EEC countries; as late as 1958, the proportion was little over a fifth. More and more, the Italian economy is bound up with the fortunes of Europe as a whole. (CONFIDENTIAL)